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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

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NOS. 76-1114, et al.

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CALIFORNIA, et al.,

Petitioners,

v.

SOUTHLAND ROYALTY COMPANY, et al.,

Respondents.

* * *

On Writs of Certiorari
To the United States Court of Appeals
For the Fifth Circuit

* * *

BRIEF AMICUS CURIAE ON BEHALF OF THE STATE OF TEXAS IN SUPPORT OF RESPONDENTS

* * *

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BRIEF AMICUS CURIAE ON BEHALF OF THE STATE OF TEXAS IN SUPPORT OF RESPONDENTS

* * *

QUESTION PRESENTED

When the lessee under a 50-year fixed-term mineral lease makes a certificated interstate sale of his leasehold gas, does he thereby encumber the land itself with an interstate sales obligation which outlives his lease?

NATURE OF THE CASE AND INTEREST OF AMICUS CURIAE

In this case, the Federal Power Commission (Commission) attempted to force Southland Royalty Company, et al. (Southland Royalty), owners of gas produced from the Waddell Ranch, "to enter into an interstate sale against their will." (A. 712). Specifically, in Opinions 737 and 737-A, the Commission ordered Southland Royalty to sell its gas to El Paso Natural Gas Company (El Paso), for resale to "low priority customers" in California.[1] Southland Royalty has contracted to sell its gas to Intratex Gas Company, which serves the citizens and industries of Houston, Texas, and environs.

The State of Texas, understandably, favors Southland Royalty's choice of purchaser. But we appear here as amicus curiae because of our concern with the basis of the Commission's holding and its potential application to other facts.

The Commission held in Opinions 737 and 737-A that Gulf Oil Corporation (Gulf), by selling surplus residue casinghead gas attributable to its 50-year fixed-term leasehold interest in the Waddell Ranch, thereby dedicated to interstate "service" all such gas ever produced from the Waddell Ranch. The Commission held that, although Gulf only owned a *lease*, it " had power to encumber" (A. 712) the *acreage* itself with an obligation to sell gas to El Paso in interstate commerce.

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[1]See Petition for Certiorari of the People of the State of California at p. 7. The "low priority" uses referred to are boiler fuel uses. Such uses are being phased out in Texas at the order of the Railroad Commission. They would be phased out nationally if the National Energy Plan passes. *See* H. R. 8444, Sec. 611 through 613.

According to the Commission, this obligation applied to any casinghead gas produced from the Waddell Ranch, regardless of owner. The Commission analogized this alleged obligation created by Gulf to a "covenant running with the land." (A. 606).

Admittedly, this case arises on highly unusual facts. Gulf's lease was a 50-year fixed-term lease entered into in 1925. By 1928, only three years later, it was recognized that such lease "had long been in disuse" and were "of no practical importance" in Texas.[2] Virtually all modern oil and gas leases, by contrast, provide that the leasehold estate remains in effect so long as either oil or gas is produced from the lease in paying quantities.[3]

The Commission's holding in this case is not, however, limited to 50-year fixed-term leases. The Commission has attempted to apply the same alleged "covenant running with the land" to ordinary oil and gas leases. *See Wessely Energy Corp. v. Arkansas-Louisiana Gas Co. and the FPC*, No. CIV-77-0159-B (W.D. Okla., issued July 29, 1977, appeal pending); *Northern Natural Gas Co. v. Crawford*, FPC Docket No. CS71-6, orders issued September 29, 1976, and December 1, 1976, *appeal pending sub nom. Harrison v. FPC*, 5th Cir. No. 76-4318. There have been hundreds of thousands of ordinary leases. Applied to ordinary leases, the doctrine that a lessee has the "power to encumber" the land with an obligation to sell any gas produced therefrom in interstate commerce would, we believe, have disastrous

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[2]*See* Walker, *The Nature of the Property Interests Created By An Oil & Gas Lease in Texas*, 7 Tex. L. Rev. 1, 15 (1928).

[3]*See* 2 E. Kuntz, Law of Oil & Gas §26.1 at p. 244 (1964); 1A W. Summers, Law of Oil & Gas §153 at p. 381 (1959).

consequences for exploration for and development of natural gas. As amicus curiae, Texas seeks to explain the nature and demonstrate the scope of these consequences.

We recognize that this Court sits to decide issues of law, not policy. But the Commission itself concedes that this case poses a "difficult situation" (A. 607), and in such a case it seems appropriate to consider the possible policy consequences of the Commission's holding. Furthermore, in their appellate briefs the Commission and its supporters have relied heavily on policy arguments. Since the Commission heard no evidence on policy issues[4] and the orders under review make no reference whatsoever to policy arguments,[5] it may be that this Court should not entertain such arguments.[6] If it does entertain such arguments, this Court should at least hear both sides.

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[4]The Commission determined that "there was no need to hold an evidentiary hearing" in this case. A. 602.

[5]In particular, the Commission's orders never mention an argument upon which it and its supporters now rely heavily: the claim that its decision is necessary to prevent other parties, in future situations, from entering into short fixed-term leases in an attempt to thwart the Commission's jurisdiction. See Part III, infra.

[6]This Court has repeatedly held that an agency's order must be upheld, if at all, "on the same basis articulated in the order by the agency itself." The Court has therefore refused to "accept appellate counsel's *post hoc* rationalizations for agency action." *FPC v. Texaco Inc.*, 417 U.S. 380, 397 (1974), *quoting Burlington Truck Lines v. U.S.* 371 U.S. 156, 168-69 (1962); *Securities & Exchange Commission v. Chenery*, 332 U.S. 194, 196 (1947). The policy arguments of the Commission and its supporters are precisely such "post hoc rationalizations of appellate counsel."

The State of Texas is well qualified to present the policy arguments against the Commission's position. Texas produced almost 40% of United States natural gas production in 1975, and has a compelling interest in the law affecting exploration for and sale of natural gas. The citizens of Texas own millions of acres of state land. The income from this land, which consists almost exclusively of the proceeds from the sale of oil and gas, is dedicated to the maintenance of a system of free public s[illegible]cls and state universities. *See* Art. 7, Sections 2 and 11, Constitution of the State of Texas. Moreover, severance taxes on the sale of Texas-produced natural gas from private as well as state lands amounted to $260 million in fiscal 1975 and are a major source of state revenues. The Commission intends to use its "covenant" to force the owners of gas reserves discovered in the future to sell their gas in the interstate market, if any prior lessee had dedicated his leasehold gas to that market.[7] This would reduce both types of state income from natural gas.

Furthermore, natural gas is vital to the State's economy. According to the United States Bureau of Labor Statistics, production of crude oil and natural gas employed more than 122,500 Texans in 1975, manufacture of drilling equipment employed 40,700 more, and the petrochemical industry, the State's most important in terms of value added, employed another 34,700.

Thus, to Texas, natural gas exploration and production means employment and education. The Commission's proposed federal "covenant" running with the land threatens these vital interests.

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[7]Of course, the land in this case is privately owned, so this brief will not further address the possible applicability of the Commission's "convenant" to lands of which the State of Texas is lessor.

SUMMARY OF ARGUMENT

The Commission held in the orders under review that a lessee can dedicate to an interstate sale all gas ever produced from the acreage he leases. The "covenant" he thereby allegedly created would "run with the land" and be binding forever, notwithstanding the termination of his lease.

Such a "covenant" would badly disrupt certainty of mineral title. Every acre of Texas land has probably been leased many times under now-expired leases. On the Commission's theory, any one or more of the prior lessees may have "dedicated" the acreage to an interstate sale. A producer who holds a current lease on the acreage or is considering acquiring such a lease cannot determine whether unknown gas reserves that may underlie it have been dedicated to interstate sale. This uncertainty will deter onshore exploration of previously leased acreage.

The court of appeals correctly held that a lessee cannot create such a "covenant running with the land" because he cannot "legally deal in or dedicate" to an interstate sale the reversionary interest of his lessor. This decision is entirely consistent with the Natural Gas Act, under which the owner of a property interest in natural gas chooses initially whether to sell his gas interstate but then must continue to sell his gas interstate. When a lessee sells his leasehold gas interstate, he commits and must continue to sell only the gas attributable to his leasehold interest.

The Commission claims that this Court must reverse the court of appeals in order to prevent future lessees and lessors from devising short fixed-term leases or leases terminable at will and using such arrangements to harm the interstate market. This argument fails for

two reasons. First, it is against a potential lessee's economic self-interest to enter into such a lease. Second, even if such leases were to occur, and if the lessees attempted to make interstate sales of gas attributable to such leases, the Commission has ample authority to protect the interstate market. The Commission can refuse to authorize the proposed sale unless the lessee obtains longer-term rights of sale from the lessor. All that the Commission cannot do is what it attempted to do in this case: pretend that a lessee can dedicate more gas than he owns, and order an owner of natural gas to make an involuntary initial sale of his gas to the interstate market.

ARGUMENT

I. CERTAINTY OF MINERAL TITLES WILL BE BADLY DISRUPTED IF IT IS HELD THAT A LESSEE CAN DEDICATE ACREAGE, NOT JUST HIS LEASE, TO INTERSTATE SERVICE.

A. *Context: Existing Oil and Gas Lease Law Fosters Exploration and Development.*

The ordinary oil and gas lease provides that a lessee's property right to explore for and produce gas continues as long as the lessee maintains production from the leased acreage in paying quantities. Thus, in the usual case of known reserves, no problem like the present one could arise: If the ordinary lessee still had production in paying quantities after fifty years, his lease would not terminate; he could continue to sell gas until the

reserves themselves were exhausted.[8] On the other hand, any lessee, whether fixed-term or ordinary, takes his lease without knowing whether or to what extent there are any gas reserves underlying the leased acreage. It is in the lessor's interest, as well as the interest of the public generally, that the acreage be explored. Hence, the ordinary lease provides for termination if the lessee has not discovered any gas by the end of a stated, relatively short primary term.[9] The ordinary lease likewise provides for termination if production commences but ceases and the lessee fails to reestablish production with further exploration or development in a very short period of time.[10] Finally, the ordinary lease is generally subject to termination for breach of an implied duty to develop.[11]

The policy of these lease provisions is to encourage drilling. The lessee must drill for whatever reserves he thinks may exist, or forfeit his lease. If he thinks there are no reserves, or no more reserves, he loses his lease and the lessor can sell the right to explore to someone else who has a different opinion or more nerve. Often,

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[8]For this reason, the language used by this Court in previous cases which have arisen under the Natural Gas Act involving ordinary leases, to which the Commission and its supporters cling, is simply irrelevant to this case. The chief example is the statement that "once so dedicated there can be no withdrawal of that supply from continued interstate movement without Commission approval." *Atlantic Refining Co. v. Public Serv. Comm'n.* 360 U.S. 378, 389 (1959). The only dedication to the interstate market involved there was the dedication "of *gas recoverable under these leases.*" 360 U.S. at 387, emphasis added.

[9]3 H. Williams, Oil & Gas Law, §603 (1975 ed.).

[10]*Id.* §§611, 613.

[11]*See* 4 H. Williams & C. Meyers, *Oil & Gas Law*, §815 (1975 ed.).

rather than wait for termination (which costs rental money) or face a suit for nondevelopment by the lessor, the lessee executes a release of his lease. The policy of producing states is to encourage this. The Commission's "covenant" would seriously interfere with these policies of promoting exploration and development.

B. *A Holding That An Oil and Gas Lessee Can Create A "Covenant Running With The Land" By Selling His Leasehold Gas Would Create a New and Disruptive Title Risk.*

The Commission has long held that, if a lessee finds some gas on his leased acreage and makes an interstate sale of his gas, any reserves which he or anyone to whom he assigns his lease *later* discovers on his lease are also dedicated to his sale. *See, e.g., Cumberland Natural Gas Co.*, 34 FPC 132, 137 (1965).[12] The *Cumberland* doctrine causes no difficulties, since the lessee obviously has the right to sell all gas that he discovers and produces under his lease and to encumber his own lease so that anyone to whom he assigns it is similarly bound.[13] But the combination of the *Cumberland* doctrine with the "covenant" that the Commission is attempting to create in this case results in serious difficulties. These difficulties may best be understood by applying the combination of the two doctrines to a very common fact situation.

Assume that an ordinary oil and gas lessee sells some

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[12]*See also Mitchell Energy Corp. v. FPC*, 533 F.2d 258 (5th Cir. 1976).

[13]The Commission recognizes that the lessee may limit his initial sale and dedication, e.g., to the gas he produces from certain depths, and that if he does so this limitation also applies to his assignees. *See, e.g., Blair-Vreeland*, 53 FPC 843, Opinion No. 724, *rev'd on other grounds, Vreeland v. FPC*, 528 F.2d 1343 (5th Cir. 1976).

gas in interstate commerce, either from a lease on Blackacre, or from some other lease that he has committed to the same gas purchase contract, under a certificate of public convenience and necessity from the Commission. Under *Cumberland*, the lessee has thereby dedicated all his leasehold interest in Blackacre reserves, even ones unknown to him at the time he first commences deliveries. But if, as the Commission held in this case, the lessee has also thereby created a federal "covenant" running with Blackacre itself, not merely with his leasehold interest, then he has dedicated to interstate service reserves that he himself never discovers. Under the Commission's theory, he has dedicated reserves that might be discovered on Blackacre by another producer, under a different lease, years after his own lease had terminated for failure of production or failure to develop.

The result is that, unless the decision below is affirmed, prospective new lessees face a novel title risk--a federal covenant to sell any natural gas they may discover to some prior lessee's interstate pipeline purchaser. The new lessee cannot protect himself against this risk by a title search. Gas purchase contracts do not have to be recorded, because they are not generally regarded as conveyances of interest in land.[14] Such contracts, as the Commission itself has conceded, are in fact usually not recorded.[15] Certificates of public convenience and necessity have never been recorded in county courthouses.

In the *Harrison* case, *supra* p. 3, the Commission has

[14]See Tex. Rev. Civ. Stat. Ann. art 6627 (Supp. 1975).

[15]*See Blair-Vreeland*, Opinion No. 724, 53 FPC 843, 8 P.U.R.4th 382, 383 (1975).

argued in response to this point that the prospective new lessee could take the names of previous lessees up to Washington, D. C., and search the Commission's files to see if these lessees had ever obtained certificates covering leases on the acreage in which the prospective lessee is interested. Aside from the exorbitant expense and difficulty involved in this proposal, it would not work because the Commission's files are incomplete. Small producers make their interstate sales under blanket certificates which do not show the acreage covered.[16] As this Court has recognized, small producers do 80% of the nation's exploratory drilling. *FPC v. Texaco Inc.*, 417 U.S. 380, 383-84 n.2. Thus, this gap is a serious one. Moreover, many producers, both large and small, sell under other producers' certificates, as the Commission's regulations permit.[17] In short, if a lessee can create a "covenant running with the land" to sell gas from the land in interstate commerce, he can create an insurmountable title risk for potential future lessees.

Furthermore, if one lessee could create such an encumbrance on Blackacre by selling his leasehold gas interstate, so could any other lessee who ever had a leasehold interest in Blackacre. If Blackacre has been leased many times, there may be many prior interstate dedications - perhaps to different interstate pipelines. To whom is the new lessee obliged to sell whatever gas he discovers? Which alleged "covenant" is binding on him?

The "covenant" that the Commission would create is obviously extremely unfair: it would obligate a new lessee, who may have acquired his lease and committed

[16]*See* 18 C.F.R. §157.40.

[17]*See, e.g.*, 18 C.F.R. §157.40(a) (3).

thousands of dollars to exploration for new reserves[18] on the assumption that he would be free to sell the gas he discovers at current market prices, to sell the gas he discovers in interstate commerce at a regulated price under some other producer's lease and contract that may have expired years ago.

But the "covenant" that the Commission is seeking to create is worse than unfair. The title uncertainties it would create are bound to have a deterrent effect on exploration of acreage that has been previously leased. Less exploration means less new gas.

C. *The Problem Posed By The Commission's "Covenant" Is Real And Substantial.*

The problem posed by the "covenant" that the Commission is attempting to create is not merely hypothetical. In the *Wessely* case, *supra* p. 3, Aquitaine had committed its leasehold interest in certain acreage in Blaine County, Oklahoma, to a gas purchase contract with Arkansas-Louisiana Gas Company (Arkla), an interstate pipeline. The lease was an ordinary one: it had a primary term of five years, and would remain in force as long thereafter as oil or gas was produced from the leased acreage by the lessee. Aquitaine discovered no gas on the acreage during the primary term, and its lease expired and was released of record. However, Aquitaine had sold gas to Arkla from other leases under the same contract and Aquitaine's small producer certificate. After the termination of Aquitaine's lease, the lessors executed a new lease to a different lessee. This lessee assigned his lease to Wessely. Arkla and the Commission asserted that any gas that Wessely might discover must be sold to Arkla for resale in interstate

[18]The average cost of a new well in Texas in 1976 was more than $175,000.

commerce, pursuant to the contract between Aquitaine and Arkla and Aquitaine's small producer certificate.[19]

Similarily, in the *Harrison* case, *supra* p. 3, an independent producer named Crawford once held a leasehold interest in six sections of land in Crockett County, Texas. Crawford sold gas from marginal gas wells on two sections under his lease to Northern Natural Gas Company (Northern) in interstate commerce. The Crawford-Northern contract was not recorded. Believing so strongly that the other four non-productive sections were worthless that he would not have "drilled another well on it with confederate money,"[20] Crawford released his interest in these non-productive sections. Harrison, et al. took a new lease, which included the acreage in which Crawford had released his interest, without any actual or constructive notice of any claim by Northern to gas they might discover--even though they conducted a title search before taking their lease. Harrison, et al. then drilled a discovery well and found a new gas field, unknown to Crawford. Northern claimed the right to buy the gas, and the Commission agreed, analogizing the case to the present one.[21] Commissioner Watt dissented, saying

[19]The Federal District Court for the Western District of Oklahoma held that Aquitaine had not dedicated the gas attributable to Wessely's lease. The Court stated that it "construes the Natural Gas Act as limiting the capacity of a party purporting to bring about a dedication of gas to interstate commerce to that of dedicating gas which he owns and as not extending to gas produced at a time after he ceases to own any interest in the premises." This decision is on appeal.

[20]According to the record in the *Harrison* case as filed with the Fifth Circuit.

[21]This decision has been appealed to the Fifth Circuit, No. 76-4318. The State of Texas has filed amicus briefs with the Fifth Circuit in support of Harrison, et al.

that "as in the *Southland Royalty Co.* case . . . the majority has exceeded its authority under the Natural Gas Act and ignored established property law."

Thus, the problem posed by the Commission's "covenant" is real, not merely hypothetical. In addition, it is a problem of substantial magnitude, not a trivial one.

Texas has verified the magnitude of this problem by reviewing the lease files maintained by its General Land Office for State-owned lands. For illustrative purposes, we selected all oil and gas leases covering public lands situated in Pecos and Chambers Counties. These are counties which have long been productive of natural gas, from which at least some gas has at different times been sold in interstate commerce, and which are again the subject of considerable exploratory interest at the present time, principally for deeper, more expensive potential reserves. Together, these counties contain 3,427,840 acres of land, both public and private.

Our search reveals some 4,040 ~~non~~ now-expired State leases since 1944 alone, covering an estimated total of 1,977,292 acres. That is, substantially more than half of the land in these two productive counties has been previously leased, to lessees who may or may not have sold gas in interstate commerce and thereby allegedly created a "covenant running with the land" under the Commission's theory. (In all likelihood, every acre in both counties has been leased, since the General Land Office records do not cover private leases.)

To find out whether this acreage might historically have been subject to numerous different leases, and thus numerous different alleged "covenants," we randomly selected ten mineral lease numbers. The geographic

area encompassed by these ten expired leases had previously been subject to a total of 90 other entirely distinct leases. In other words, a prospective lessee of public lands in Pecos or Chambers County could expect that the State had already leased all or part of a particular tract *nine different times.*

This hypothetical lessee could not know whether one or more of his nine predecessors had ever executed an interstate gas purchase contract and made certificated deliveries thereunder, and thereby created an alleged "covenant." The General Land Office did not begin maintaining records of gas contracts executed on State-leased lands until November 1, 1974.[22] As previously noted, there are no comprehensive public records of interstate gas contracts which may have been entered into by lessees of private lands.

The title uncertainties which result from the Commission's proposed federal "covenant" are a powerful argument against its creation. As demonstrated in respondents' briefs, to hold with the Commission that a lessee can create a "covenant" which outlasts his leasehold interest would depart from well established Anglo-American real property law. This Court has properly said that judicial "concern for unsettling titles" makes the "substantive rules governing the law of real property . . . peculiarly

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[22]The State of Texas has used state records to illustrate its point, because of relative ease of access. We do not thereby concede, or even suggest, that the holding in the present case could be applied to the more than 16 million acres in which the State of Texas owns the mineral interest. The present case does not involve such acreage. Any attempt by the Commission to apply its doctrine to such lands would raise a series of constitutional and statutory issues not presented by this case.

subject to the principle of *stare decisis.*" *State Land Board v. Corvallis Sand & Gravel Co.*, 429 U.S. 363, 381-82 (1977).

Thus, unless the court of appeals was patently wrong in reversing the Commission, or unless the court of appeals' decision will itself have seriously adverse consequences, this Court should affirm the court of appeals. As demonstrated briefly below, the court of appeals was plainly correct and its holding poses no threat to the public interest.

II. THE COURT OF APPEALS CORRECTLY HELD THAT A MINERAL LESSEE WHO MAKES A CERTIFICATED SALE OF HIS LEASEHOLD GAS DOES NOT THEREBY CREATE A FEDERAL "COVENANT RUNNING WITH THE LAND."

The court of appeals held that a lessee cannot create an interstate dedication which outlasts his lease and "runs with the land." Specifically, the court of appeals held that Gulf, as owner of a leasehold interest, "could not legally deal in or dedicate" to interstate commerce gas that might be produced by the reversioners "upon termination of Gulf's estate." *Southland Royalty Co. v. FPC*, 543 F.2d 1134, 1137 (5th Cir. 1976). This decision is entirely consistent with the Natural Gas Act as well as real property law.

The court of appeals' decision rests on simple recognition that a reversionary property interest has its own identity, separate and apart from the leasehold interest. Since the lessee does not own the reversionary interest, he may not "legally deal in or dedicate" it to his interstate sale. The owner of the reversionary interest, like any other owner of a property interest in natural gas, has the right to make his own initial choice of where to sell the gas attributable to his interest.

The court of appeals' decision does not in any way weaken or abridge the Natural Gas Act. Under the Natural Gas Act, *once* an owner of natural gas had dedicated *his* gas to an interstate sale, he must obtain abandonment authorization from the Commission before he can remove *his* gas from his interstate sale. *Atlantic Refining Co. v. Public Service Comm'n of N.Y.*, 360 U.S. 378, 389 (1959). The court of appeals simply held that Gulf dedicated only its leasehold gas to its interstate sale, and did not dedicate Southland Royalty's reversionary gas.

III. THE COMMISSION'S JURISDICTION WILL NOT BE UNDERMINED BY REAFFIRMATION OF THE LEGAL PRINCIPLE THAT A LESSEE CAN DEDICATE ONLY HIS LEASEHOLD INTEREST.

A. *Introduction: The Commission's Policy Argument.*

In this Court, the Commission and its supporters contend that the decision of the court of appeals "would severely impair the Commission's regulatory authority." (FPC Brief at p. 29). They speculate that the decision below "creates a substantial incentive for lessors and producers to draft their leases in ways permitting termination when market conditions make it advantageous."*(Id.* at p. 30). The Commission itself gives no examples, much less any evidence, of such potent draftsmanship, but merely claims that "it would not be difficult to devise lease arrangements that maximized both parties' options to leave the interstate market when this served their mutual advantage." *(Id.* at p. 30, n.29). Of the other petitioners and supporting amici, two are less bashful, hypothesizing short fixed-term leases, leases terminable at will, et certera. (Briefs

of El Paso at p. 23-25 and AGD at p. 9).

As previously noted, Texas doubts that this argument can be used to sustain the orders under review. It was not relied on or even mentioned by the Commission in those orders, there is no evidence in the record whatsoever to support the Commission's theory, and it obviously does not arise on the facts of this case. The lease in this case was entered into in 1925, almost thirty years before it was even held that the Natural Gas Act applies to a producer's interstate sale. The 1925 lease provided for a very long, rigidly fixed term. In 1975 that lease expired according to its terms and not by any action of the lessee.[23] But even if the argument can be considered, it should be rejected. The problem hypothesized is not a realistic one, and the Commission has ample authority to deal with it if it should materialize.

B. *The Decision Below Will Not Foster Evasion of the Commission's Jurisdiction.*

The basic fallacy of the theory that the decision of the court of appeals will cause lessors and lessees to agree upon short fixed-term leases, leases terminable at will, etc., is that it ignores the lessee's economic self-interest. He pays a bonus and rentals for the lease to obtain the right to explore for and produce gas from the leased acreage. The lessee's major investment, however, is not the lease bonus or rentals, but his drilling costs. His only opportunity to recover these costs is by selling the gas (or oil) that he discovers on the leased acreage. Thus, he has the strongest possible reason for assuring himself that *if* he finds any natural gas, he will be permitted to produce

[23]On the contrary, Gulf fought all the way to the Supreme Court of Texas in an unsuccessful effort to extend the lease past its term. *Gulf Oil Corp. v. Southland Royalty Co.*, 496 S.W.2d 547 (Tex. 1973).

and sell all of it. Short fixed-term leases would threaten to deprive him of his ability to recover his investment. Obviously, leases terminable at will would do so. Perhaps the Commission or its supporters can conceive a form of lease instrument satisfactory to a lessee while still capable of the mischief they fear, but in the more than two years of this litigation they have so far failed to identify any such instrument.

Assume, however, that other counsel are more imaginative than those representing the parties to the present case, and do succeed in devising such lease arrangements. The Commission has ample authority to protect interstate gas consumers against the harm such leases would allegedly threaten.

If a lessee approaches the Commission with a certificate application for a sale of gas produced from such hypothetical lease, the Commission can reject the application on the grounds that the proposed sale is not required by the public convenience or necessity.[24] Thus, in *Transco Exploration Co.*, Docket No. CI77-306, the Commission initially denied an application for a limited-term certificate with pregranted abandonment by order issued June 27, 1977. Transco Exploration had acquired the lease from which the gas would be produced by assignment from another producer, who had retained an option to convert his royalty interest into a partial working interest. The Commission said that, as a matter of policy, it should not grant a certificate unless the potential working interest owners also committed their gas. In an order on rehearing, issued September 19, 1977, the Commission reversed itself on the grounds that an exception was necessary on the facts of the Transco Exploration case: the applicant

[24]*See* Section 7(e) of the Natural Gas Act, 15 U.S.C. §717f(e).

was an interstate pipeline's producing affiliate which had spent substantial ratepayer money (advanced by the pipeline) on the well before the policy was announced. The Commission said that, in the future, no such applications would be granted even to the pipeline affiliates.

Alternatively, the Commission can grant the certificate, conditioned upon the would-be seller obtaining from his lessor a sufficiently long-term and stable leasehold interest to satisfy the Commission.[25]

Only one of the Commission's supporters has even attempted to answer this argument. The "Associated Gas Distributors" (AGD) claim that the Commission's power over certification is "no answer" because "in that case the entire supply might never be made available to the interstate market." (AGD Brief at p. 9). Actually, it is AGD's "answer" which is "no answer." All that AGD is saying is that, if the decision below is allowed to stand, a producer may choose whether or not to sell his gas to the interstate market in the first place. This is precisely what the Natural Gas Act provides, and precisely what this Court has held that it provides. Under the Natural Gas Act, a producer who applies for a certificate to make an interstate sale has an "undoubted right to stand firm on its own application, and reject the proffered certificate." *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137, 141 (1960). The Commission cannot force a producer "to dedicate its gas to interstate commerce."[26]

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[25] *See* Section 7(e) of the Natural Gas Act, 15 U.S.C. § 717f(e).

[26] *Public Serv. Comm'n v. FPC*, 463 F.2d 824 (D.C. Cir. 1972).

CONCLUSION

For the foregoing reasons, the State of Texas as amicus curiae respectfully submits that the decision of the Fifth Circuit is sound in policy as well as in law. If an oil and gas lessee could create a federal "covenant running with the land," mineral title would be thrown into great uncertainty and new exploration in areas which have been previously leased would be significantly deterred. In contrast, no harm to the public interest would come from permitting the Fifth Circuit's decision to stand. We respectfully urge this Court to affirm the decision below.

Respectfully Submitted,

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